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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 93-215
	)	
Rate Regulation	)	

REPLY COMMENTS OF AUSTIN, TEXAS; KING COUNTY, WASHINGTON; AND MONTGOMERY COUNTY, MARYLAND

Nicholas P. Miller
Joseph Van Eaton
Lisa S. Gelb
MILLER & HOLBROOKE
1225 19th Street, NW
Suite 400
Washington, D.C. 20036
(202) 785-0600

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Summary

(1) The City of Austin, Texas; King County, Washington; and Montgomery County, Maryland ("Local Government Coalition") hereby submit reply comments in the above-docketed proceeding.

(2) The Local Government Coalition urges the Federal Communications Commission ("FCC") to ensure that its cost of service guidelines conform to the mandate of the Cable Television Consumer Protection and Competition Act of 1992 ("Act") to eliminate monopoly rents from cable services. The cost of service proceedings should not enable operators to justify rates that would not exist in a competitive market.

(3) The Local Government Coalition advocates certain procedures that will reduce the administrative burdens associated with cost of service regulation. For example, establishing a single, industry-wide rate of return, and requiring operators to use the same method of regulation for all tiers (with specific procedural guidelines set forth in these reply comments) will create significant efficiencies, without sacrificing consumer

protection. These suggestions are superior to the "streamlining" approaches favored by the cable industry.

(4) The cable industry's claims in support of allowing operators to include excess acquisition costs in rate base are without merit. Original cost should generally be the basis for setting rates in cost of service proceedings.

(5) The FCC's cost of service rules should not allow any expense that does not benefit subscribers to be included in rates. Operators should only recover to the extent they actually incur an expense. In addition, there is no reason to allow operators to receive a profit on programming, and allowing such a mark-up would create perverse incentives.

(6) The Local Government Coalition strongly favors a productivity offset to be used in the FCC's price cap regulation of cable.

DRAFT

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REPLY COMMENTS OF AUSTIN, TEXAS; KING COUNTY, WASHINGTON; AND MONTGOMERY COUNTY, MARYLAND

Introduction

The City of Austin, Texas; King County, Washington; and Montgomery County, Maryland ("Local Government Coalition") hereby submit reply comments in the above-docketed proceeding.

The Local Government Coalition believes the Federal Communications Commission ("FCC") must establish guidelines that will make cost of service proceedings a workable option for both cable operators and regulators and that will allow operators a fair but not excessive profit. Most importantly, the regulatory system designed by the FCC must not enable operators to misuse cost of service proceedings as a device to justify monopoly profits which regulation is intended to eliminate.

The Local Government Coalition filed comments in this proceeding which asked the Commission to:

1. Make sure that all revenues and cost savings, and not merely expenses, are reflected in rates;

2. Ensure that subscribers only pay for expenses from which (and to the extent that) they benefit; and

3. Prohibit operators from using cost of service proceedings as a way to game the system.

In this reply, the Local Government Coalition discusses those points raised by other commenters which are inconsistent with the above principles of regulation. Upon review, the Local Government Coalition is confident that the Commission will recognize the validity of its experience in telephone cost of service regulation and will find that body of law, and the legal precedents that created it, persuasive in addressing the major questions surrounding allowable costing methodologies to eliminate unreasonable cable operator profits.

I. THE FCC SHOULD ESTABLISH A THRESHOLD SHOWING FOR OPERATORS SEEKING TO INITIATE COST OF SERVICE PROCEEDINGS

Cost of service regulation should not be available every time an operator is unhappy with its benchmark rate. Operators should be required to use benchmarks in all but extreme cases where benchmarks would work a real injustice.[1] The Local

[1] Many of the industry comments highlight problems or inadequacies with the FCC's benchmarks. NCTA comments at 2-3; Continiential Comments at 5. Continental Cablevision, Inc. ("Continental") states that "[n]o specific benchmark could accurately reflect cost elements, except by pure chance." Continental Comments at 5. The Local Government Coalition agrees. However, the solution is not to allow a full or partial cost of service showing any time an operator has a cost that varies from the benchmark norm. That approach would simply multiply the number of cost of service showings. Instead, the better approach is to improve the underlying benchmarks, so that they reflect those reasonable costs of providing service. Time

Government Coalition recommends that the FCC require that a cost of service showing be available only where an operator can show the following as a preliminary matter. The operator must show that benchmark rates for regulated services will not permit a reasonable return on the operator's used and useful equipment, taking into account revenue from all sources, including unregulated services which use that equipment. See Local Government Coalition comments at 4-5. Such a threshold requirement is consistent with the FCC's desire to limit the number of cost of service proceedings to truly warranted instances, and to require use of the benchmark system as the primary method of regulation. Requiring a threshold showing that benchmarks are inadequate is also a reasonable means to protect against operator abuses of the FCC's benchmark system.[2]

Warner comments, NERA Study at 16. While the FCC claims that it has established a "cost-based benchmark," Implementation of Sections of the Cable Television Consumer Protection and Competitor Act of 1992, Rate Regulation, First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, MM Dockets 92-266, FCC 93-428, ¶ 13, 58 Fed. Reg. 46718 (September 2, 1993). This is so largely because the FCC looked at information on rates, rather than raw cost data, in setting its benchmarks. The Local Coalition continues to believe the FCC erred fundamentally when it used rates from cable systems that do not engage in real, head-to-head competition as surrogate data for industry costs plus a reasonable profit. Once the benchmarks are improved to better reflect a systems' costs of providing service, the need to rely on a secondary method of regulation will be further reduced.

[2] Comments filed by the cable industry make much of the fact that cost of service proceedings are intended merely to serve as a secondary or "backstop" mode of regulation. See Time Warner Comments at 16-21. Similarly, the FCC justified its decision not to permit regulators to initiate cost of service proceedings because it believed opportunities for cost of service showings should be limited. Implementation of Sections of the

In addition, a preliminary, or prequalification showing is consistent with well-established ratemaking principles. The Supreme Court has held that an agency responsible for establishing rules for rate regulation has broad procedural discretion, and is not limited to a particular method of rate-setting. Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944). The question is whether the resulting rate, not the method employed, is just and reasonable. Id. The FCC's benchmark system will, in most cases, give operators a more than reasonable profit on their services. A cost of service option is not necessary. Id.; In re Permian Basin Area Cases, 390 U.S. 747, 770 (1968) (suggesting that relief from group rates based on individual costs of service may not be constitutionally mandated). If the FCC nevertheless wishes to permit rates different from those derived by the benchmark system, those rates should only be possible in extreme circumstances where a rate different than the benchmark is necessary in order to continue service. This requires more than a simple assertion that the

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Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, Report and Order and Further Notice of Proposed Rulemaking, MM Docket 92-266, FCC 93-127, ¶ 191, 58 Fed. Reg. 29736 (May 21, 1993) ("Report and Order"). Operators must be discouraged from using the threat of a cost of service proceeding to intimidate regulators lacking the resources to conduct a careful review of the proposed rate. In addition, some operators have suggested to franchising authorities that they will seek a rate that is only slightly above the benchmark. The regulator might well decide that a full review would not be worthwhile relative to the potential benefit to subscribers. In this way, operators could easily abuse the cost of service option and charge an above-benchmark rate regardless of whether such rate was justified by its costs.

benchmark rate won't provide a reasonable profit. See Bowles v. Willingham, 321 U.S. 503, 518 (1944) (fact that high cost operator is more seriously affected by regulation does not invalidate regulation); Hope, 320 U.S. at 606 (there is no constitutional requirement that provider of a regulated service will have revenues that exceed costs).

II. REVENUE REQUIREMENT ISSUES

A. The FCC Should Establish an Industry-Wide Rate of Return

Cable industry commenters differ on whether the FCC should establish a single, national rate of return. For example, NCTA and TCI reject an industry-wide rate of return. However, Continental and Community Antenna Television Association ("CATA") advocate a single rate of return, and Viacom International, Inc. says there is "little question" that a single rate of return is appropriate. Viacom comments at 44. The Local Government Coalition supports a single rate of return, for several reasons. First, a single rate of return promotes the interests of efficiency. See Continental Comments at 4. Second, an industry-wide rate of return is consistent with telephone regulation. Such parallel regulation, where feasible and economical, should be established, particularly in light of the convergence of the cable and telephone industries. GTE comments at 9-12. In addition, the FCC should take advantage of the expertise it has developed in the telephone area, rather than reinventing the regulatory wheel.

In addition, the alternative to a single rate of return is problematic. Some cable industry members urge the FCC to develop a rate of return on an ad hoc basis, claiming that those systems not utilizing the cost of service option should not be considered in establishing a rate of return. TCI comments at 40. The inefficiencies of this are obvious. There is no way of knowing, in advance, which systems will rely on cost of service showings. Moreover, they may change from year to year. Thus, a particular review to determine the appropriate rate of return would be necessary in every cost of service showing. In addition, operators (and their investors) would have no advance notice of the allowed rate of return. Nor have those supporting an individualized rate of return adequately shown why it is necessary, particularly in light of the substantial added administrative burden it would involve. The FCC should thus establish a single, industry-wide rate of return.

While the Local Government Coalition is not recommending a specific figure for the Commission to apply as the industry-wide rate of return, we note that the affidavit of James H. Vander Weide presents a recommended return that is better supported than the rates of return recommended by the industry (See Joint Bell comments, Affidavit of James I. Vander Weide). Mr. Vander Weide determines the debt/equity structure and the cost of debt of the industry by looking at publicly traded companies that are primarily cable TV operators. In contrast, the Peter Pitsch study includes 19 companies, many of which operate media and other major businesses distinct from local cable television systems, to determine a debt/equity structure, but then uses a "primarily cable" group to ascertain the cost of debt (See CATA comments, Pitsch study at 19ff). The Pitsch approach is internally inconsistent, because the cost of debt is theoretically affected by the debt/equity structure; if he uses a cost of debt figure for more highly leveraged companies that are primarily cable operators, he should then apply the capital structure of these firms only, and not some larger group. In addition, Pitsch applies the cost of bonded debt, rather than the true embedded cost of debt from all sources, including bank loans. Vander Weide more correctly applies the embedded cost of all debt.

AUS Consultants, like Pitsch, also apply assumptions that are not appropriate for the cable industry and other questionable procedures to arrive at their recommended rates of return (See Cable Operators and Associates comments, AUS White Paper). They assume a 50/50 debt equity structure on the basis of the observation that the actual structures "diverge" among firms in the business, but if one selects companies that are primarily local cable system operators from their list (AUS White Paper at 68), the actual capital structures are much more highly leveraged. AUS White Paper at 68. They also assume a 40% effective tax rate, when the actual effective tax rates of most primarily cable firms have been much less than that over the past several years. And they manipulate the time periods of the data they apply, including forecast information as well as historical information to project rates of return that are notably higher than if the historical data alone were applied.

B. Rates Should be Based on the Original Cost of the System

The cable industry seeks to dissuade the FCC from using original cost as the basis for setting cable rates. Not surprisingly, cable companies want instead to collect returns on the purchase price the most recent owners paid for the cable system. The cable companies raise numerous arguments in support of allowing acquisition cost in rate base: (1) the sales were made at arm's length and thus the purchase price reflected fair value; (2) acquisition cost above book value is common, and does not reflect expectation of monopoly profits; (3) even if the purchase price does reflect expectation of monopoly profits, the seller, not the purchaser, got the benefit of the excessive purchase price and should thus be able to pass on the expense; (4) companies no longer have records of original cost; and (5) if the full purchase price is not recoverable, operators will be unable to service their debt.

The various industry-supported studies, and the obvious effort and expense the industry has sustained to carry its argument to the FCC does prove how important the Commission's resolution of this issue is to consumers. However, the industry's aggressive attempt to claim excessive purchase amounts as a responsibility of system subscribers speaks for itself. The Commission should not be a party to encouraging economic inefficiency or social unfairness. Investors who make dumb investments should bear the consequences of their foolishness. Regulation should protect subscribers from those risks, not the opposite, as the industry suggests.

1. Excess acquisition costs must be disallowed, even where sales were made at arm's length

The FCC has always insisted that the burden of proof is on the entity seeking to include excess acquisition costs to demonstrate that the "price paid for property accurately reflects its value to the ratepayers or is otherwise in the public interest." Amendment to Part 65 of the Commission's Rules to Prescribe Components of the Ratebase and Net Income of Dominant Carriers, Order on Reconsideration, No. 86-497, 4 FCC Rcd 1697, 1704 (released February 22, 1989).

The FCC has long held that excess acquisition costs should not ordinarily be included in rate base. According to the FCC:

> It has been this Commission's opinion, one that is shared by substantial body of the regulatory authorities, that the price paid for properties in excess of the original cost (net of depreciation), when it was first devoted to public use, will be scrutinized with a most critical eye as to the appropriateness of including such excess cost in the carrier's rate base . . . The reason for this opinion is simple and sound. The ratepayer should not be burdened with paying a return on an increase in the rate base when there has been no increase in plant devoted to providing him service, unless the carrier can demonstrate that the ratepayer benefits by the acquisition . . . Utility ratemaking precedents make it clear that acquisition adjustments are not normal inclusions in rate bases and a carrier intending to include such accounts has a definite burden of showing with some specificity how and to what extent customers were benefitted by acquisition for amounts in excess of network cost.

American Television Relay, Inc., 65 F.C.C.2d 387, 393-394 (emphasis added). See also Amendment to Part 65 of the Commission's Rules to Prescribe Components of the Ratebase and Net Income of Dominant Carriers, Order on Reconsideration, CC Docket No. 86-497, 4 FCC Rcd. 1697, 1704 (1989) (recognizing that FCC has "always placed on the carrier the responsibility of justifying the inclusion of amounts claimed for plant acquisition adjustments"). Accord AT&T and Western Union Private Line Cases, 34 F.C.C. 217 (1963). Moreover, where the excess acquisition costs are large, as they often are in the cable industry, there is even greater need for concrete justification. American Television Relay, Inc., supra, at 394.

Contrary to the industry's claims, excess acquisition costs are disallowed in regulated rate bases even where the buyer and seller were operating at arm's length. American Television Relay, Inc., supra, at 394 (excess acquisition costs disallowed even though there was no question that parties were dealing at arm's length).

2. Excess acquisition costs reflect anticipation of monopoly profits

In a monopoly industry not subject to effective competition, economic theory tells us that there will be a wide variance between the original or replacement cost and the acquisition cost of the monopoly. The cable industry does not dispute this, but instead tries to minimize the fact, asserting that such discrepancy is common even in competitive industries. Continental comments at 36-37. The industry is arguing a decided issue. Both Congress and the FCC have concluded that the discrepancy between replacement and purchase costs, that is, the "Tobin's Q," reflects a significant level of monopoly power in the cable industry. S. Rep. No. 92, 102d Cong., 2d sess. 9-11, reprinted in 1992 U.S.C.C.A.N. 1133, 1141-1144 ("Senate Report"); Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Service, Report, MM Docket 89-600, 5 FCC Rcd 4962, 5033, 5079 (released July 31, 1990). Indeed, the fact that the cable industry wields monopoly power is hardly a matter of dispute.[3] Even taking criticisms of Tobin's Q theory into account,[4] the evidence shows that the excess acquisition prices paid for cable systems have been based on investor belief that cable was and would remain an unregulated monopoly, and that cable system purchasers could recover the cost of their purchase by charging monopoly rates to subscribers.[5]

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[3] See e.g., Senate Report at 8-9, reprinted in 1992 U.S.C.C.A.N. 1140-1142 (industry recognizes itself as a monopolist); Id. at 13, reprinted in 1992 U.S.C.C.A.N. 1145-1146 (only 53 communities out of 11,000 have some overbuild); Report and Order at ¶ 15 n. 30 (FCC recognizes that only "tiny percentage" of communities face effective competition).

[4] Senate Report at 10-11 reprinted in 1992 U.S.C.C.A.N. 1142-1144; Report, 5 FCC Rcd at 4999, and Appendix E.

[5] One industry study points out that stock prices in the cable industry were not significantly affected even after reregulation was announced. Viacom comments, The Brattle Group study at 25. The study concludes that this proves that prices in the industry were not inflated to reflect monopoly profits, because the prices did not go down even when upcoming regulation was announced. Id. at 27. But this conclusion does not follow. Instead, the market fluctuated when murmurings of the FCC's regulation were released, but prices went back up after the

The suggestion that the FCC rely on market value of cable systems as the proper figure for rate base is nonsensical. Prices paid for systems are based on expected revenues. Prices paid say nothing about whether those revenues are based on rates that are reasonable or not. See Duquesne Light Co. v. Barasch, 488 U.S. 299, 309 n. 5 (assets cannot be valued by the stream of income they produce, because the stream of income was the very object of the rate proceeding). Accord MacDonald v. Federal Power Commission, 505 F.2d 355, 364 (D.C. Cir. 1974) (can't assume market price in unregulated market is just and reasonable). There is no "fair," that is, competitive, market value for such cable systems. Federal Power Commission v. Texaco Inc., 417 U.S. 380, 399 (1974) (recognizing a distinction between "actual" and "true" market price).

Some industry commenters propose to allow the full purchase price minus "quantifiable" monopoly rents. See Viacom comments at 36; Adelphia et al. comments at 16-18. Such comments recognize that acquisition prices may indeed incorporate expectation of monopoly profits. However, they provide no justification for abandoning established FCC precedent of putting the burden on the purchaser (rather than the regulator) of demonstrating why the purchase price was reasonable. The National Cable Television Association ("NCTA") claims that not

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actual benchmarks were released. This lack of ultimate change in stock prices in fact reflects investor belief that benchmark regulation will not force down industry cashflows. It says nothing about whether those cashflows do or do not contain monopoly rents.

including acquisition costs in the rate base would unfairly harm operators, who created the expense for the privilege of owning the system, while unfairly favoring subscribers who, according to NCTA, get the benefit of such expenditures. NCTA comments at 14. But NCTA does not explain what "benefit" subscribers get from an operator purchase of a developed and operating system. Nor does NCTA offer any reason why subscribers should have to pay for a single system many times over, as system investors buy and sell the same system with no changes, with each purchase adding more and more to the rate base.

Continental provides samples of systems it purchased at then-record prices, along with a comparison of a system which has never been bought or sold, in an effort to show that purchases of systems above original cost may be a good investment. But this argument misses the point. The Local Government Coalition does not dispute that, in an unregulated environment, a cable investor can profit greatly even where the most recent purchase price exceeds the original cost many times over. The question is whether subscribers benefit -- and should be forced to pay -- for such excess acquisition costs.

According to Continental, its acquisition of the Fresno, California system was a good investment, because it was able to significantly increase subscribership through a rebuild, through programming and customer service improvements, and through heavy marketing efforts. Continental comments at 22. Perhaps the most obvious question is: why was it reasonable to pay such a substantial premium for a system that needed significant capital and other improvements? Continental makes no claim that it was buying a particularly high quality or state of the art system. In fact, it needed to add channel capacity and improve signal quality at the outset. Continental comments at 24. Likewise, the fact that it needed to make heavy investments in improving customer service and marketing shows that Continental was not paying the premium because the system was well-established or had a good reputation in the area. Id. What Continental was buying -- and what made the record purchase price acceptable to Continental's stockholders -- was the opportunity to sell monopoly cable service at unregulated prices. While this opportunity may well have been a great boon to investors, it did not benefit subscribers, and they should not be forced to pay beyond the actual cost of the improvement that Continental made in the system. American Television Relay Inc., 65 F.C.C.2d at 393 (amounts paid for (1) the going concern nature of a business, (2) established routes and position of carrier, and (3) business potential of extending into new areas of operation inure to the benefit of investors, not customers, and customers should not be forced to pay for those investments).[6] Far from making its intended point, Continental's examples demonstrate why the FCC

[6] Thus, not only should subscribers not be forced to pay for the excess acquisition costs paid by Continental, they should not be required to pay for the amounts spent on marketing and promoting the operator's services.

should not look to the purchase or market value in establishing a rate base for cable systems.[7]

The intangible assets identified by the industry do not account for the vast discrepancy between replacement and acquisition costs that are common in the cable industry. Courts have already decided, based on the industry's own representations, that monopoly cable companies do not have "good will." Tele-Communications, Inc. v. Commissioner of Internal Revenue, 95 T.C. No. 36 (1990). TCI's experts in that case, "flatly reject the existence of goodwill in a monopolistic environment." Id. at 40. Customers return only because they have no other choice. Reply brief of Telecommunications, Inc. at 147-154, Tele-Communications, Inc. v. Commissioner of Internal Revenue, supra.

Cable operators assert that other intangibles, such as subscriber lists, start up losses, and the value of a going concern, also exist and should be included. Continental comments at 26. But those commenters make virtually no attempt to quantify those intangibles. In fact, the amounts allocable to those other intangible items are not significant. The FCC has already analyzed other possible causes for the wide variance between acquisition and replacement costs in the cable industry, and has concluded that those other factors "could account for no

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[7] Notably, Continental's information about the Brockton and Fresno systems does not include what rates Continental expected to charge as justification for the purchase price, or the extent to which those rates were increased because of the purchase price.

more than a fraction of the value of the q ratio." Report, 5 FCC Rcd at 5075-5076, ¶ 12. See also Id. at 5077.

3. Operators must bear the risk of reregulation and should not be permitted to pass on to subscribers excess acquisition costs

Some operators claim that, even if acquisition costs do in fact reflect anticipation of monopoly rents, the seller, not the current operator, got the benefit of the excess acquisition costs. It is thus unfair (the argument goes) to stick the current operator with risks associated with the purchase price paid. That risk should be passed on to subscribers. Adelphia comments at 18. This claim is contrary to the Cable Act. It is contrary to FCC precedent. And it is contrary to established ratemaking principles.

The Cable Television Consumer Protection and Competition Act of 1992 ("1992 Act") is intended to protect consumers and to promote competition. Incorporating monopoly profits into rates for regulated services is directly contrary to both of those goals.[8] The 1992 Act stipulates that rates should be no higher than rates that would exist if there were competition. 47 U.S.C. § 543(b)(1). Rates may not be unreasonable. 47 U.S.C. § 543(c)(1). Rate regulations should take into account a reasonable profit. 47 U.S.C. § 543(b)(2)(C)(vii) (emphasis added). Rate regulations should ensure expansion which is

[8] It was in fact the cable industry's abuse of its monopoly power through excessive prices that led to reregulation. It would defeat the very intent of the 1992 Act to allow operators to reap, through regulation, the benefits of those very abuses the 1992 Act was designed to eliminate.

economically justified. 1992 Act, Section 2(b)(3) (emphasis added). The 1992 Act mandates reasonable rates. Rates that included monopoly rents are not "reasonable" under the 1992 Act because they are higher than those that would exist in a competitive market. Allowing operators to include in rates a purchase price that incorporates anticipated monopoly rents consequently violates the provisions of the 1992 Act.

The FCC has previously recognized that regulated entities may not pass on to customers the cost of investments that were not designed to benefit those customers. It said, "[w]e cannot require customers to pay rates which are intended to cover return on portions of investment which represent factors benefiting investors and not users." American Television Relay, Inc., 65 F.C.C.2d at 393. Certainly, purchase prices paid for systems, with the intent that such investments would be recovered through monopoly rents, were never intended to benefit anyone other than investors, and should not be recoverable through regulation. The fact that the investors made a bad prediction -- namely, that cable rates would continue to be unregulated -- should not inure to the detriment of subscribers.

The cable investor who speculated that cable would continue as an unregulated monopoly should not be protected against the error, by forcing subscribers to guarantee the operation against any losses. Any entity entering an unregulated market takes the risk that its investment might be worth less if the market becomes regulated. Bowles v. Willingham, 321 U.S. at 517-518. Munn v. Illinois, 94 U.S. (4 Otto) 113 (1876).[9]

It is an accepted principle of ratemaking that only prudent investments should be included in the rate base. Duquesne Light Co. v. Barasch, 488 U.S. at 309 (1989). An investment that was not designed to improve service or in any way to benefit subscribers, and in fact is certain to harm subscribers, is not prudent. Excess payments based on speculation of future regulatory decisions are imprudent expenditures and subscribers should not be responsible to reimburse cable owners for any losses attributed to that speculation.

4. Inadequate records regarding original cost may be adequately addressed on a case by case basis

Some cable industry commenters assert that original cost is not a viable solution because relevant records have not been retained. NCTA comments at 10; TCI comments at 17. However, other commenters submit evidence of original cost, and clearly have retained such information. Specific anecdotal testimony from a handful of operators claiming that they lack adequate records gives no indication whether this is a widespread phenomenon.

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[9] The unfairness of the lost investment is overstated by the industry. The expected rate of return inherent in the purchase price reflected risk assumptions. The future high rates and profits were not and should not be guaranteed.

In any event, the fact that some operators may be unable to produce records of original cost is hardly insurmountable.[10] Such concerns may be addressed on a case-by-case basis, and do not preclude use of original cost for rate base purposes. When original cost data is shown to be unavailable, the regulator can rely on the net book value for tangible assets or on industry wide cost data for comparable systems.[11] On a going-forward basis, however, the present book value should never be exceeded. Every system has a present book value obtained in accordance with GAAP. This figure should never be exceeded as the base for all future rate determinations related to original costs. That is, future sales prices should not be used, after the initial regulations are issued. Otherwise, operators will be encouraged to inflate sales prices and to repeatedly sell the properties to constantly increase the system's rate base.[12]

5. <u>Using original cost won't significantly affect operators' ability to service debt</u>

Some operators claim that refusing to allow full acquisition costs will not allow operators to service their debt. NCTA

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[10] Regulations of telecommunications plant provides for original cost estimates where the original cost is not known. 47 C.F.R. § 32.2000(b).

[11] The Local Government Coalition believes that the current book values of most systems likely involves some amount of write-up, but believes that this is still an alternative.

[12] In addition, tangible assets for which rates are separately determined, such as converters and remote control units or capitalized installation costs, should not be included in the rate base for basic or other programming services. To do so would provide a "double return" on these assets.

comments at 13. This argument misses the point as to who carries the risk of an unwise business investment. Benchmarks already provide a significant investment safety net for system owners. Operators are not compelled to rely on the cost of service rules. As operators point out, benchmarks are the primary regulatory method, and cost of service proceedings are intended to be used merely as a backstop. Under the FCC rules, cost of service showings will only be initiated at the option of operators.

Benchmarks will provide an adequate return to the industry and its investors and bankers. Even where the benchmarks mandate a rate reduction, that reduction will (by the industry's own admission) not significantly impair the industry's financial obligations or plans. See e.g. Malone: Rules Harsh but 'Immaterial', Multichannel News, April 5, 1993 at 40; TCI Sees Mild Hit From Rate Cuts, Multichannel News, July 26, 1993 at 1, 51 (TCI executives assert that regulations will have minimal financial impact). Time Warner Takes Mild Re-reg Hit, Multichannel News, August 2, 1993 at 2, 45 (Time Warner executives state that revenues will decline, but it will continue its planned $5 billion upgrade and will rarely need to appeal benchmarks by making cost of service showings). See also Study Sees Slight Damage From All Re-regulation, Multichannel News, July 19, 1993 at 82, 84. TCI now claims to the FCC that the benchmarks will place it in technical default of six loan covenants and that the benchmarks will have a "material adverse effect on earnings and cash flow." TCI comments at 8. But, in